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PAGE 01 PARIS 05867 01 OF 04 212136Z
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LIMITED OFFICIAL USE SECTION 01 OF 04 PARIS 05867

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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC): REVIEW OF THE NETHERLANDS, FEBRUARY 9, 1978

1. SUMMARY: AFTER REFLECTING ON THE PARADOX THAT AT
TIMES CARETAKER GOVERNMENTS AND ABOVE NORMAL ECONOMIC
PERFORMANCE GO TOGETHER (AS OCCURRED IN THE NETHERLANDS
IN 1977), EDRC AGREED THAT THE OUTLOOK FOR THE DUTCH
ECONOMY IN 1978, AT 2.5 PERCENT REAL GROWTH AND AN
AUGMENTED CURRENT ACCOUNT SURPLUS, WAS NOT CONSISTENT
EITHER WITH DUTCH MEDIUM-TERM OBJECTIVES OR WHAT IS
DESIRABLE AREA-WIDE UNDER OECD ECONOMIC STRATEGY.
NETHERLANDS DELEGATION (HEADED BY VERBERG OF THE
MINISTRY OF ECONOMIC AFFAIRS AND INCLUDING EIGHT
OTHER DELEGATES FROM THE HAGUE) ARGUED THAT THE GON
HAD TAKEN STEPS (INCLUDING 500 MILLION STIMULUS FOR
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PAGE 02 PARIS 05867 01 OF 04 212136Z

1978 HELD IN RESERVE PENDING OUTCOME OF WAGE NEGOTI-
ATIONS) WITHIN LIMITS OF PRUDENCE TO STIMULATE THE
ECONOMY. IN CONTRAST, THE SECRETARIAT AND THE EDRC
FELT THAT MORE, PARTICULARLY IN THE FORM OF TAX CUTS,
COULD BE DONE. GON DELEGATION OUTLINED THE PROPOSED
"INVESTMENT PREMIUM SCHEME" AND VARIOUS OTHER ASPECTS
OF CURRENT ECONOMIC POLICY, BUT WAS NOT CONVINCING ON

MANY OF THE SELF-IMPOSED "NORMS" WHICH CONSTRAIN ACTION TO IMPROVE ECONOMIC PERFORMANCE. EDRC WELCOMED THE PERSISTENCE OF THE GON IN LIMITING THE GROWTH OF THE PUBLIC SECTOR IN ORDER TO STIMULATE ACTIVITY IN THE PRIVATE SECTOR, PARTICULARLY THROUGH AN IMPROVED CLIMATE FOR PRIVATE INVESTMENT. MISSION APPRECIATED THE PARTICIPATION OF EC COUNSELOR DUNN IN THE NETHERLANDS REVIEW. END SUMMARY

2. RECENT TRENDS AND 1978 OUTLOOK: NETHERLANDS DELEGATION STATED IT WAS AS AMAZED AS THE SECRETARIAT BY THE OUTCOME OF 1977, PARTICULARLY THE STRENGTH OF DOMESTIC DEMAND AND THE WEAKNESS IN THE FOREIGN SECTOR.

-- PRIVATE CONSUMPTION WAS STRONG, BASICALLY DURABLES, ESPECIALLY AUTOMOBILES AND TOURISM. A SURPRISINGLY STRONG INVESTMENT PERFORMANCE WAS ATTRIBUTED PARTIALLY TO SOME SECTORAL BOTTLENECKS THAT WERE OCCURRING, DESPITE LOW UTILIZATION RATES ON THE MACRO LEVEL, AS WELL AS GOVERNMENT PROGRAMS TO SUPPORT INVESTMENT, BOTH GENERALLY AND IN SPECIFIC SECTORS; FOR EXAMPLE, THE MARITIME PLAN (SEE BELOW).

-- DUTCH DELEGATION POINTED OUT THAT PRICE COMPETITIVENESS OF DUTCH PRODUCTS WAS HARMED MORE THAN INDICATED BY THE AGGREGATE APPRECIATION OF THE EFFECTIVE EXCHANGE LIMITED OFFICIAL USE

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PAGE 03 PARIS 05867 01 OF 04 212136Z

RATE. DURING 1977, EXCHANGE RATE HAD APPRECIATED ONLY 2 PERCENT VIS-A-VIS SUPPLIERS TO THE DUTCH MARKET, WHILE IT APPRECIATED 3.3 PERCENT VIS-A-VIS COMPETITORS; SINCE 1971 THE RESPECTIVE FIGURES ARE 17.5 AND 21 PERCENT. ALSO, WEAK WORLD DEMAND CAUSED A REDUCTION IN PROFIT LEVELS FOR EXPORTS WHICH, TAKEN WITH THE BUOYANT INTERNAL DEMAND, CAUSED PRODUCERS TO TURN INWARD TO THE DOMESTIC MARKET FOR HIGHER PROFITS, THUS REDUCING THE EXPORT EFFORT.

-- NETHERLANDS AUTHORITIES ESTIMATE THAT OF THE 200,000 UNEMPLOYED, 75,000 CAN BE ATTRIBUTED TO CYCLICAL FACTORS. UNEMPLOYMENT WAS HELD DOWN IN 1977 BY ONE-TIME 40,000 PERSON WITHDRAWAL FROM THE LABOR FORCE, DUE TO SPECIAL INCENTIVES OFFERED BY THE GOVERNMENT THROUGH THE SOCIAL SECURITY SYSTEM FOR EARLY AND DISABILITY RETIREMENTS.

-- LOOKING TO 1978, THE EDRC CONCLUDED THAT SECRETARIAT AND DUTCH AUTHORITIES COULD PROBABLY AGREE ON A SINGLE

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PAGE 01 PARIS 05867 02 OF 04 212140Z
ACTION EUR-12

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LIMITED OFFICIAL USE SECTION 02 OF 04 PARIS 05867

FORECAST OF APPROXIMATELY 2.5 PERCENT INCREASE IN TOTAL DOMESTIC DEMAND AND 2.8 PERCENT INCREASE IN GDP. THE RATE OF GROWTH OF BOTH CONSUMPTION AND INVESTMENT EXPENDITURES FALL OFF SUBSTANTIALLY (TO 0.7 AND 2.4 PERCENT RESPECTIVELY FROM 2.5 AND 11.6 PERCENT) FROM 1977 LEVELS WHEREAS EXPORTS ARE EXPECTED TO RETURN TO GROWTH RATES NEAR THE RATE OF GROWTH OF WORLD TRADE. INFLATION AT 5 PERCENT YEAR/YEAR AND 3 PERCENT FOR 1978. CURRENT SURPLUS RISING TO 4-1/4 BILLION GUILDERS AFTER FALLING TO NEAR BALANCE IN 1977. THE U.S. DELEGATION NOTED THAT CERTAIN ASPECTS OF THIS FORECAST WERE PARTICULARLY UNFORTUNATE IN THAT 1977 HAD SHOWN AN EXCESS OF TOTAL DOMESTIC DEMAND OVER DOMESTIC PRODUCTION, A DESIRABLE SITUATION FOR A COUNTRY IN CURRENT ACCOUNT SURPLUS, WHEREAS FOR 1978, THE SITUATION WOULD BE REVERSED WITH A LARGE CURRENT ACCOUNT SURPLUS PROJECTED TO RE-EMERGE. THE NETHERLANDS DELEGATION AGREED THAT PERFORMANCE IN LINE WITH THE 1978 FORECAST WAS NOT DESIRABLE, PARTICULARLY IN TERMS OF THE RATE OF DOMESTIC DEMAND GROWTH,
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PAGE 02 PARIS 05867 02 OF 04 212140Z

BUT FOR VARIOUS REASONS NOTED BELOW, FELT THAT THE GOVERNMENT HAD DONE ALL IT COULD FOR THE MOMENT IN TERMS OF ECONOMIC STIMULUS.

3. ECONOMIC POLICY -- FISCAL: DUTCH DELEGATION STRONGLY REAFFIRMED THE INTENT OF GON TO RESTORE CONFIDENCE AND VITALITY TO THE PRIVATE SECTOR BY RESTRAINING THE RELATIVE GROWTH OF THE PUBLIC SECTOR OVER THE MEDIUM TERM. ACCORDINGLY, BOTH THE 1 PERCENT LIMIT FOR THE ANNUAL GROWTH OF THE PUBLIC SECTOR BURDEN AND THE MEDIUM-TERM NORM OF LIMITING BUDGET DEFICITS TO 5 PERCENT OF GDP (I.E., LONG-TERM 4 PERCENT NORM PLUS ONE PERCENT FOR PUBLIC INVESTMENT) WERE CITED AS INDICATORS. DUTCH DELEGATION WAS ANXIOUS THAT THE EDRC ACCEPT THE PROPOSED 1978 BUDGET DEFICIT (6 PERCENT OF GNP) AS A DESIRABLE LEVEL OF GOVERNMENT STIMULUS FOR 1978. WHEN PRESSED, VERBERG NOTED THE HALF-BILLION GULDERS HELD "IN RESERVE" FOR POSSIBLE USE DURING 1978 TO REDUCE COSTS OR RAISE PURCHASING POWER (DEPENDING ON THE OUTCOME OF THE WAGE NEGOTIATIONS). A DECISION ON HOW THIS SUM WILL BE USED IS EXPECTED AT THE END OF MARCH. NUMEROUS EDRC MEMBERS POINTED TO THE DIFFERENCE BETWEEN (A) ADDITIONAL PUBLIC EXPENDITURES AND TAX CUTS AS CYCLICAL FISCAL POLICY TOOLS AND (B) OVERALL LONGER-TERM PROGRAM TO LIMIT THE GROWTH OF THE PUBLIC SECTOR, BUT THE DUTCH DELEGATION GENERALLY CHOSE NOT TO ACKNOWLEDGE THE DIFFERENCE. RESPONDING TO A QUESTION ON THE EXCESS PROFITS TAX (VAD), DUTCH DELEGATION SAID THAT THE CURRENT GOVERNMENT WOULD LIKELY PROPOSE SUCH A TAX TO THE PARLIAMENT, BUT IN A HEAVILY MODIFIED FORM. THEY TOOK PAINS TO STRESS THE FACT THAT THIS WOULD BE A TAX ON "EXCESS" PROFITS AND NOT AN ATTACK ON PROFITS THEMSELVES, WHICH NEED TO RISE OVERALL.

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PAGE 03 PARIS 05867 02 OF 04 212140Z

4. MONETARY POLICY: RESPONDING TO QUESTIONS ABOUT THE "TIGHTNESS" OF MONETARY POLICY AND THE PERCEIVED "DANGER" OF EXCESS LIQUIDITY, THE REPRESENTATIVE OF THE CENTRAL BANK (DEN DUNNEN) STATED THAT, IN 1976, EXCESS LIQUIDITY HAD RESULTED IN SOMETHING OF AN EXPLOSION IN THE MORTGAGE MARKET WHEN BANKS MADE MORTGAGES AVAILABLE (FUNDED BY SHORT-TERM DEPOSITS) TO A VERY ACTIVE MARKET IN EXISTING HOUSING. A SHARP INCREASE IN THE PRICE OF EXISTING HOUSING SPILLED OVER INTO DEMAND FOR CONSTRUCTION OF NEW HOUSING, CREATING PRICE INCREASES AND BOTTLENECKS IN THAT SECTOR. TO DAMPEN DEMAND FOR MORTGAGES, THE CENTRAL BANK FELT IT DESIRABLE TO REQUIRE BANKS TO FIND LONG-TERM FINANCING FOR THEIR LONG-TERM

(MORTGAGE) LENDING. THIS LED TO ESTABLISHING LIMITS ON CREDIT EXPANSION AND THE DECISION TO LOWER THE "LIQUIDITY RATIO." DEN DURNEN ADDED THAT THE MONETARY GUIDELINES HAD PLACED NO RESTRAINT ON INDUSTRIAL INVESTMENT ACTIVITY AND HAD NOT BEEN THE MAIN RESTRAINING FACTOR FOR THE CONSTRUCTION SECTOR. HE INDICATED THAT THE TARGET OF PERCENT ANNUAL REDUCTION IN THE LIQUIDITY RATIO WOULD BE MAINTAINED, BUT THAT IT WOULD BE APPLIED IN A FLEXIBLE WAY SO THAT LIQUIDITY COULD BE SOAKED UP IN SLACK PERIODS UNTIL THE RATIO RETURNS TO MORE NORMAL LEVELS WHILE NOT INTERFERING WITH GROWTH IN PERIODS OF ACCELERATION.

5. INCOMES POLICY: ALTHOUGH CENTRALIZED LABOR NEGOTI-

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PAGE 01 PARIS 05867 03 OF 04 212144Z
ACTION EUR-12

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LIMITED OFFICIAL USE SECTION 03 OF 04 PARIS 05867

ATIONS WERE A TRADITION IN THE NETHERLANDS, THEY HAD BROKEN DOWN DURING THE PAST THREE YEARS OVER DIFFERENT ISSUES. NEVERTHELESS, FOR 1978, GON DELEGATION EXPECTED THAT A DECENTRALIZED AGREEMENT WOULD BE REACHED ON ZERO NEGOTIATED INCREASES. WITH 0.5 PERCENT INCREASE CARRIED OVER FROM OLD AGREEMENTS, 1.5 PERCENT INCREASE IN EARNINGS DUE TO WAGE DRIFT AND 5 PERCENT RISE FROM COL INDEX, GOVERNMENT FORECAST ASSUMES 7 PERCENT NOMINAL EARNINGS

INCREASE. ANOTHER ASPECT OF THE 1978 NEGOTIATIONS WAS THE APPEARANCE OF SO-CALLED "LABOR PLACE AGREEMENTS" IN WHICH THE UNIONS EXPLICITLY ACCEPT THAT QUESTION OF EMPLOYMENT LEVELS IS AN ELEMENT OF TRADEOFF IN CONSIDERING TRADITIONAL QUESTIONS OF WAGES AND WORKING CONDITIONS. ACCORDING TO DUTCH DELEGATION, GON SUPPORTS THIS CONCEPT, BUT ALSO WISHES TO INSURE THAT SUCH AGREEMENTS DO NOT MAKE THE ECONOMY MORE INFLEXIBLE BY PREVENTING ADJUSTMENT OF EMPLOYMENT TO OVERALL ECONOMIC CONDITIONS.

6. FOREIGN EXCHANGE POLICY: THE DUTCH DELEGATION TOOK LIMITED OFFICIAL USE

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PAGE 02 PARIS 05867 03 OF 04 212144Z

EXCEPTION TO CERTAIN REFERENCES IN THE SECRETARIAT DRAFT WHICH PORTRAYED THE GUILDER AS EXERTING UPWARD INFLUENCE ON THE EUROPEAN "SNAKE." THEY DESCRIBED DUTCH PRACTICE AS THAT OF DOMESTIC POLICY ADJUSTMENT TO REMAIN WITHIN THE EXCHANGE RATE LIMITS IMPOSED BY THE SNAKE, AS OPPOSED TO THE FRG WHICH ALLOWS THE SNAKE TO ADJUST AS A MEANS OF ISOLATING ITS DOMESTIC POLICY FROM EXTERNAL FORCES. THAT DUTCH AUTHORITIES WILL CONTINUE TO PURSUE POLICIES TO PROMOTE A CURRENT ACCOUNT SURPLUS BALANCED BY LONG-TERM CAPITAL OUTFLOWS WAS REITERATED BY DUTCH DELEGATIONS DESPITE SHARP QUESTIONING OF THE DESIRABILITY OF CURRENT SURPLUSES GIVEN OVERALL OECD DEFICIT VIS-A-VIS OPEC.

7. INDUSTRIAL POLICY: THE DUTCH DELEGATION OUTLINED THE "INVESTMENT PREMIUM SCHEME" WHICH WOULD BE MADE PUBLIC WITHIN A WEEK OF THE EDRC MEETING. THE SCHEME WAS DESCRIBED AS A "PARAFISCAL" OPERATION WHICH WOULD FUNCTION THROUGH REBATES ON TAXES (WHETHER TAXES ARE DUE OR NOT) AND WOULD NOT REQUIRE ADDITIONAL BUREAUCRATIC APPARATUS TO ADMINISTER. IT PROVIDES FOR A BASIC PREMIUM FOR ALL INVESTMENT, 11 PERCENT FOR FIXED INVESTMENT AND 7 PERCENT FOR NON-FIXED, PLUS CUMULATIVE SUPPLEMENTS FOR:

(A) SMALL SCALE ACTIVITIES -- 6 PERCENT ADDITIONAL PREMIUM ON A DIGRESSIVE SCALE UP TO 800,000 GUILDERS A YEAR;

(B) VERY LARGE PROJECTS -- A FIXED ABSOLUTE SUPPLEMENT FOR EACH EXTRA EMPLOYMENT POSITION CREATED BY MARGINAL INVESTMENT ABOVE 50 MILLION GUILDERS;

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PAGE 03 PARIS 05867 03 OF 04 212144Z

(C) REGIONAL DIVERSIFICATION -- ALTHOUGH NOT QUANTITATIVELY SPECIFIED, THIS SUPPLEMENT WOULD ENCOURAGE INVESTMENT OUTSIDE THE ROTTERDAM/WEST HOLLAND AREA; AND,

(D) INVESTMENT PROJECTS CONSISTENT WITH THE PHYSICAL PLANNING SCHEMES AND WHICH PROVIDE EMPLOYMENT IN THOSE AREAS WHERE ADMINISTRATIVE PHYSICAL PLANNING HAS ESTABLISHED (OR INTENDS TO CREATE) POPULATION CENTERS -- 12-20 PERCENT ON THE FIXED PORTION OF THE INVESTMENT.

THE INVESTMENT ACCOUNT IS EXPECTED TO BE IN OPERATION BY APRIL 1ST. IN ADDITION TO THE INVESTMENT PREMIUM SCHEME, THE GOVERNMENT IS SEEKING TO REORGANIZE CERTAIN SECTORS OF THE ECONOMY THROUGH A SO-CALLED "RESTRUCTURING COMPANY," WHICH IS A TRIPARTITE UNDERTAKING TO STUDY THE NEEDS OF INDIVIDUAL INDUSTRIAL SECTORS AND TO PROPOSE REORGANIZATION AND RATIONALIZATION PLANS WHICH CAN THEN QUALIFY FOR FISCAL SUPPORT. THE "MARITIME PLAN" FOR THE SHIPBUILDING INDUSTRY (WHICH PROVIDES SUBSIDIES TO REDUCE BUT NOT ELIMINATE LOSSES ON ALL SHIPS BUILT) IS AN EXAMPLE OF THIS APPROACH (ALTHOUGH NOT DONE WITHIN THE "RESTRUCTURING COMPANY") AND WAS A PRINCIPAL CAUSE OF THE REPORTED 50 PERCENT INCREASE IN INVESTMENT IN SHIPS DURING 1977.

8. THE MEDIUM TERM: DUTCH DELEGATION WELCOMED AND GENERALLY AGREED WITH THE SECRETARIAT'S ANALYSIS OF THE ROLE OF NATURAL GAS EXPLOITATION FOR MEDIUM-TERM POLICY

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PAGE 01 PARIS 05867 04 OF 04 212141Z
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LIMITED OFFICIAL USE SECTION 04 OF 04 PARIS 05867

IN THE NETHERLANDS, NOTING THAT THE KEY PROBLEM WAS MAINTAINING THE COMPETITIVENESS OF THE DUTCH ECONOMY AS A WHOLE (BOTH MANUFACTURES AND SERVICES) IN LIGHT OF THE HIGH LIVING STANDARD, EXPANDED SOCIAL PROGRAMS, AND STRONG CURRENT ACCOUNT SITUATION MADE POSSIBLE BY NATURAL GAS. A NEW MEDIUM-TERM PLAN WAS REPORTED TO BE IN PREPARATION AND IS EXPECTED TO BE PRESENTED BY THE DUTCH GOVERNMENT IN JUNE. THE DELEGATION WAS THEREFORE UNABLE TO GIVE DETAILS ON MEDIUM-TERM POLICY, BUT DID OUTLINE SEVERAL PREMISES WHICH WOULD BE IN THE PLAN, NAMELY:

-- THE CONTINUED RESTRAINT OF THE PUBLIC SECTOR SEEN AS A KEY TO RE-ESTABLISHING THE HEALTH OF THE PRODUCTIVE PRIVATE SECTOR;

-- THE PHILOSOPHY OF CONSERVING THE NATURAL GAS RESOURCES OVER THE LONG RUN BY REDUCED RATES OF EXPLOITATION. THUS, A DECLINE IN THE CONTRIBUTION OF GAS TO LIMITED OFFICIAL USE

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PAGE 02 PARIS 05867 04 OF 04 212141Z

THE EXTERNAL SECTOR IS FORESEEN AFTER THE LATE 1970'S. (AS AN EXAMPLE OF THIS CONSERVATION PROGRAM, THE DUTCH DELEGATION NOTED THAT GAS WAS NOT PERMITTED TO BE USED AS A FUEL FOR GENERATION OF ELECTRICITY, REQUIRING POWER COMPANIES TO USE CURRENTLY MORE EXPENSIVE IMPORTED PETROLEUM.)

-- AN UNEMPLOYMENT TARGET FOR 1982 OF 150,000 AS OPPOSED TO THE 275,000 NOW SHOWN IN MEDIUM-TERM PROJECTIONS. THESE FIGURES REPRESENT BASICALLY STRUCTURAL UNEMPLOYMENT; I.E., DUE PRIMARILY TO CAPITAL SHORTAGE, BUT INCLUDING 50,000 DUE TO FRICTIONAL FACTORS.

9. CONCLUSIONS: AFTER REPEATED PROBING BY DELEGATIONS ON THE DESIRABILITY OF FURTHER FISCAL STIMULUS IN 1978, AND EQUALLY REPEATED CLAIMS BY THE DUTCH DELEGATION THAT SUBSTANTIAL MEASURES HAD ALREADY BEEN TAKEN, THE EDRC CONCLUDED THAT:

(A) GIVEN THE IMPORTANCE OF NATURAL GAS IN THE DUTCH ECONOMY, IT IS ESSENTIAL THAT SHORT-TERM ECONOMIC POLI-

CIES BE CONSISTENT WITH MEDIUM-TERM POLICIES DESIGNED TO RESTRUCTURE THE DUTCH ECONOMY TO ACCOMMODATE THE CONTRIBUTION MADE BY NATURAL GAS. WITHIN THIS CONTEXT, THE NETHERLANDS IS IN THE HAPPY SITUATION OF FACING NO BALANCE OF PAYMENTS CONSTRAINT AND HAVING VIRTUALLY MASTERED THE INFLATION PROBLEM.

(B) THE 1978 FORECAST AS PRESENTED BY THE DUTCH AND THE SECRETARIAT SHOW 2.5 PERCENT GROWTH IN DOMESTIC DEMAND AND SOMEWHAT FASTER GROWTH OF DOMESTIC PRODUCTION, WITH AN INFLATION RATE OVER THE YEAR OF 3 PERCENT, AND A CURRENT SURPLUS OF 4-1/2 BILLION GUILDERS.
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PAGE 03 PARIS 05867 04 OF 04 212141Z

(C) THE FORECAST WAS HOWEVER NOT ACCEPTABLE IN TERMS OF THE MEDIUM-TERM GOALS DESIRED BY THE DUTCH AUTHORITIES, NOR CONSISTENT WITH THE OVERALL OECD STRATEGY FOR SUSTAINED NON-INFLATIONARY GROWTH IN THE AREA AS A WHOLE. AND THAT,

(D) THERE WAS DISAGREEMENT AS TO WHETHER THE GOVERNMENT COULD DO MORE TOWARDS RAISING THE LEVEL OF ECONOMIC ACTIVITY TO A MORE DESIRABLE LEVEL. THE SECRETARIAT AND THE EDRC FELT THAT MUCH COULD BE DONE PARTICULARLY IN THE AREA OF TAX CUTS WHILE RECOGNIZING THAT SOME STEPS IN THE RIGHT DIRECTION HAD BEEN TAKEN WHEREAS THE DUTCH DELEGATION FELT THAT THE GOVERNMENT HAD DONE AS MUCH AS IT COULD FOR THE TIME BEING.
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